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Message Text

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TO SECSTATE WASHDC 7966
INFO AMEMBASSY ABU DHABI
AMEMBASSY AMMAN
USINT BAGHDAD
AMEMBASSY CAIRO
AMCON DHAHRAN
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FOR UNDERSECRETARY COOPER AND ASSISTANT SECRETARY BENNET

E.O. 11652: N/A
TAGS: ETDR, EFIN, ELAB, BEXP, TC
SUBJECT: IMPACT OF RECENT INCOME TAX INCREASE FOR OVERSEAS AMERICANS

REF: 76 KUWAIT 5699

1. SUMMARY: IMPACT OF TAX REFORM ACT OF 1976 PROVISIONS AFFECTING AMERICANS EMPLOYED OVERSEAS COULD BE SERIOUS IN TERMS OF LOSS OF US EXPORT TRADE AND PARTICIPATION IN MIDDLE
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EAST DEVELOPMENT PROJECTS. RESULT WILL BE DRASTIC REDUCTION OF NUMBER OF AMERICANS EMPLOYED BY BOTH US AND LOCAL FIRMS. COST WILL HAVE TO BE RECKONED IN LOSS OF US FIRM COMPETITIVENESS AND PERFORMANCE AND SHIFT OF PURCHASING OF PRODUCTS FROM US TO EUROPE AND JAPAN. THIS REDUCTION OF US SALES OF GOODS AND SERVICES WILL BE ACCOMPANIED BY REDUCTION IN US INFLUENCE IN KEY MIDDLE EAST AREA AS RESULT OF

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DEPARTURE OF NOT ONLY AMERICAN BUSINESSMEN, BUT ALSO US PROFESSORS--MUCH IN DEMAND IN KUWAIT AND SAUDI ARABIA--WHO CANNOT AFFORD BEAR NEW TAX BURDEN. THIS DOUBLE IMPACT DIRECTLY UNDERCUTS IMPORTANT US FOREIGN POLICY OBJECTIVES OF INCREASING AMERICAN INFLUENCE AND PROMOTING US TRADE. IT IS RECOMMENDED THAT VIGOROUS CAMPAIGN BE MOUNTED BY ADMINISTRATION, LED BY STATE AND SUPPORTED BY OTHER CONCERNED AGENCIES, TO PERSUADE CONGRESS TO AMEND THESE TAX PROVISIONS SO INJURIOUS TO US POLICY OBJECTIVES. END SUMMARY.

2. THE EMBASSY HAS PREVIOUSLY REPORTED ITS CONCERN OVER THE EFFECTS OF THE A1976 TAX REFORM ACT ON THE EMPLOYMENT OF AMERICANS OVERSEAS (REFTEL). WE HAVE RECEIVED NUMEROUS COMPLAINTS FROM ALL SIDES, BUT PARTICULARLY FROM THOSE AMERICANS WHO ARE EMPLOYED BY KUWAITI RATHER THAN AMERICAN FIRMS.

3. SURPRISINGLY, THERE ARE A CONSIDERABLE NUMBER OF AMERICANS EMPLOYED BY LOCAL FIRMS IN KUWAIT AND THE OTHER PERSIAN GULF STATES. SOME WORK DIRECTLY FOR NOW NATIONALIZED COMPANIES, LIKE THE KUWAIT OIL COMPANY, WHILE OTHERS ARE EMPLOYED AT AN EXECUTIVE OR TECHNICAL LEVEL BY JOINT VENTURES OR LOCAL ENTERPRISES IN ALL FIELDS OF ACTIVITY, THE LATTER PRINCIPALLY IN MAJOR TRADING COMPANIES WHOSE BUSINESS RUNS INTO THE MILLIONS OF DOLLARS ANNUALLY. UNLIKE THEIR COMPATRIOTS EMPLOYED BY AMERICAN FIRMS, THESE AMERICANS CANNOT EXPECT THEIR LOCAL EMPLOYERS TO COVER THE SUBSTANTIAL INCREASE IN THEIR TAX BILLS AS THE RESULT OF THE NEW ACT. TAX ACT HAS LIMITED OFFICIAL USE

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PARTICULARLY NEGATIVE EFFECT HERE, SINCE ARTIFICIALLY HIGH RENTS ($30,000 PER YEAR FOR MODEST THREE BEDROOM APARTMENT) COVERED BY EMPLOYERS ARE INCLUDED AS INCOME. SINCE MOST AMERICANS WORK UNDER CONTRACTS WITH HOUSING PROVIDED, NEGOTIATED BEFORE THE PASSAGE OF THIS ACT, THEY ARE PARTICULARLY VULNERABLE TO THE IMPACT OF ITS PROVISIONS, ESPECIALLY RETROACTIVELY. (RECENT INDICATIONS THAT RETROACTIVE PROVISION WILL BE AMENDED BY CONGRESS, ARE MOST WELCOME.)

4. ONE EXAMPLE IN THIS CONNECTION WORTH CITING IS THE ALGHANIM INDUSTRIES, ONE OF THE LARGEST LOCAL EMPLOYERS OF AMERICANS, WHICH CONSIDERS ITSELF A MULTINATIONAL ENTERPRISE (SALES OVER $200 MILLION PER YEAR). ACCORDING TO INFORMATION PROVIDED BY ALGHANIM'S VICE PRESIDENT FOR CORPORATE DEVELOPMENT (AN AMERICAN), ALGHANIM EMPLOYS SEVEN AMERICAN SENIOR EXECUTIVES AND 25 AMERICANS IN MIDDLE MANAGEMENT SLOTS. ALL OF THESE WERE HIRED BEFORE THE EFFECTIVE DATE OF THE TAX REFORM ACT, MOSTLY AS THE RESULT OF SEARCHES INITIATED BY US EXECUTIVE RECRUITING FIRMS. OUR SOURCE ALSO REPORTS

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THAT SEVENTEEN MANAGEMENT SEARCH ASSIGNMENTS ARE OUTSTANDING
AND THAT ALL OF THESE HAVE NOW BEEN DIRECTED TO EUROPE THROUGH
EUROPEAN-BASED RECRUITING AGENCIES. ANOTHER EXAMPLE IS THAT
OF FRUIN-COLNON, LARGE US CONTRACTING FIRM DOING MULTI-MILLION
DOLLAR BUSINESS IN JOINT VENTURE WITH KUWAIT PARTNER OPERATING
AS MIDDLE EAST INTERNATIONAL CONTRACTING COMPANY. FIRM
ESTIMATES THAT AS RESULT OF WINNING CONTRACTS FOR TURN-KEY
PROJECTS, IT COULD HAVE IMPORTED AS MUCH AS $175 MILLION
DOLLARS IN EQUIPMENT AND MATERIALS FROM US IN NEXT COUPLE
OF YEARS. BECAUSE OF NEW TAX LAW COMPANY HAS BEEN UNABLE
TO ATTRACT NEW US EMPLOYEES AND IS RAPIDLY LOSING EXISTING
AMERICAN EMPLOYEES. SINCE FOREIGN CITIZEN REPLACEMENTS WILL
DESIGN PROJECTS CALLING FOR FOREIGN EQUIPMENT, COMPANY IS
GOING AHEAD ON ASSUMPTION THAT IS PURCHASES FROM US WILL BE
DRASTICALLY CUT. IT HAS THEREFORE CLOSED ITS SAN FRANCISCO
PROCUREMENT OFFICE, AND IN LETTER TO EMBASSY STATES THAT,
BECAUSE OF SITUATION BROUGHT ON BY TAX LAW, IT DOES "NOT
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PROPOSE TO DO FURTHER PROCUREMENT IN THE US OF MAJOR EQUIP-
MENT OR MATERIALS." THESE ARE ONLY TWO OF NUMEROUS
EXAMPLES.

5. THE TAX REFORM ACT HAS LITERALLY PRICED AMERICAN EXECUTIVES
AND MANAGERS OUT OF THE MIDDLE EAST EMPLOYMENT MARKET. IN
A DIRECT COST COMPARISON BETWEEN AN AMERICAN AND A BRITISH
MANAGER, ALGHANIM FOUND IT WOULD HAVE TO PAY THE AMERICAN
THREE TIMES THE GROSS SALARY OF THE BRITISHER TO ATTRACT
THE FORMER. ALGHANIM PREFERS TO HAVE AMERICANS, BUT
CANNOT JUSTIFY THE DIFFERENCE IN COST.

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6. WHILE THE IMPACT OF THIS SITUATION IS NOT AS GREAT ON AMERICAN CORPORATIONS OPERATING OVERSEAS AS IT IS ON THE INDIVIDUAL AMERICAN WORKING FOR A FOREIGN FIRM, ITS IMPACT ON THE FORMER IS ALSO CONSIDERABLE. THE OVERSEAS TAX PROVISIONS ADD MEASURABLY TO THE COMPANY'S COSTS ON ONGOING PROJECTS WITH CONSEQUENT LOSS IN POTENTIAL PROFITS AS WELL AS ADD AN FURTHER COST FACTOR TO THE ESTIMATES SUBMITTED IN A PROJECT BID. SINCE US COMPANIES ALREADY HAVE CONSIDERABLE DIFFICULTY IN MAINTAINING THEIR COMPETITIVENESS AGAINST FOREIGN-PARTICULARLY JAPANESE--FIRMS, THE ADDITIONAL TAX
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COSTS THEY WILL HAVE TO ABSORB WILL UNDOUBTEDLY REDUCE THEIR CHANCES TO WIN BIDS. SOME WILL SEEK TO REPLACE THEIR AMERICAN EMPLOYEES WITH FOREIGN ONES, BUT THIS WILL NOT ALWAYS WORK BECAUSE OF SPECIALIZED SKILLS REQUIRED FOR MANY OF THE HIGH TECHNOLOGY PROJECTS NOW BEING UNDERTAKEN IN THE MIDDLE EAST.

7. THE TAX REFORM ACT DOES NOT ONLY STRIKE AMERICAN BUSINESS EXECUTIVES--IT HAS AN EQUALLY UNFAVORABLE IMPACT UPON AMERICAN PROFESSORS EMPLOYED BY LOCAL ARAB UNIVERSITIES. AMERICAN PROFESSORS ARE MUCH PREFERRED AT KUWAIT UNIVERSITY--AND WE UNDERSTAND ALSO AT THE SAUDI ARABIAN UNIVERSITIES. KUWAIT UNIVERSITY, UNDER KUWAITI ADMINISTRATIVE MANAGEMENT FOR THE FIRST TIME (REPLACING EGYPTIANS), HAS AS ITS OBJECTIVE THE DEVELOPMENT OF AN AMERICAN-STYLE UNIVERSITY SET-UP. NATURALLY, ITS AMERICAN UNIVERSITY-TRAINED LEADERSHIP IS SEEKING US PROFESSORS TO HELP THEM WITH KUWAIT UNIVERSITY'S ADMINISTRATIVE AND ACADEMIC REFORM. BECAUSE OF THE EXCESSIVELY HIGH COST OF HOUSING, WHICH IS PROVIDED BY THE UNI-

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VERSITY AND INCLUDED AS FULLY TAXABLE INCOME UNDER THE NEW LAW, AMERICAN PROFESSORS WILL NOT BE ABLE TO CONTINUE FOR LONG WITH KU, AND OTHER AMERICANS WILL NOT FIND IT POSSIBLE TO ACCEPT APPOINTMENTS HERE IN THE FUTURE. ALSO THOSE OLDER PROFESSORS WORKING HERE, WHO HAVE ACCUMULATED SOME INVEST-MENTS, WILL SIMPLY NOT BE ABLE TO AFFORD THE TAX BILL.

8. ALL THIS ADDS UP TO A VERY SERIOUS--VERY DISTURBING--SITUATION WITH RESPECT TO US POLICY AIMS AND OBJECTIVES IN THE MIDDLE EAST. I CAN COMMENT ONLY ON THE MIDDLE EAST BECAUSE I AM UNAWARE OF THE EXTENT OF THE TAX REFORM ACT'S EFFECT IN OTHER AREAS OF THE WORLD, ALTHOUGH I PRESUME IT IS NOT INSIGNIFICANT.

9. THE IMPACT HERE-IN THE ARAB WORLD--WHN ADDED TO THAT OF THE BOYCOTT--WILL BE REFLECTED IN A VERY SUBSTANTIAL LOSS OF PURCHASES OF US GOODS AND EQUIPMENT WITH A CONSEQUENT LIMITED OFFICIAL USE

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POTENTIAL EFFECT ON EMPLOYMENT LEVELS IN CERTAIN INDUSTRIES AT HOME. I BELIEVE IT IS FAIR TO SAY THAT AMERICAN EXECUTIVES WORLING FOR FOREIGN FIRMS GENERALLY RECOMMEND THE PURCHASE OF US GOODS AND EQUIPMENT IN PREFERENCE TO THOSE OF OTHER COUNTRIES. THE HIGH QUALITY OF US EQUIPMENT AND PRODUCTS AND RELIABILITY OF THE SERVICE PROVIDED BY THEIR MANUFACTURERS STILL MAKE US PROFUCTS COMPETITIVE DESPITE THE HIGHER FREIGHT COST AND LONGER DELIVERY TIMES.

10. OVER THE ABOVE THE LOSS IN TRADE WILL BE THE CONCOMITANT LOSS IN AMERICAN INFLUENCE WHICH IS SPREAD BY AMERICANS EMPLYED ABROAD. IN THEIR OWN WAY, OUR BUSINESSMEN ARE AMBASSADORS FOR AMERICAN AND CERTAINLY THEIR INFLUENCE HERE IN KUWAIT OVER THE YEARS HAS NOT BEEN INCONSIDERABLE. I ENCOUNTER REGULARLY EXPRESSIONS OF VIEWS OF THE US FROM KUWAITIS WHO RELATE THEIR ATTITUDE TO THAT OF RESPONSIBLE AMERICANS WITH WHOM THEY HAVE WORKED OR ASSOCIATED. THIS IS AN INTANGIBLE, BUT VALUABLE ASSET WHICH I BELIEVE MAKES MY JOB OF REPRESENTING US POLICIES HERE IN KUWAIT A LOT EASIER, BECAUSE IT HAS REFLECTIONS IN ALL SORTS OF FIELDS OF ACTIVITY, POLITICAL AS WELL AS ECONOMIC.

11. IN THE SAME VEIN, THE ROLE OF AMERICAN PROFESSORS IN SPREADING US INFLUENCE AMONG THE BURGEONING AND IMPRESSIONABLE STUDENT COMMUNITY--THE NEXT GENERATION OF LEADERS IN THIS IMPORTANT AND VOLATILE PART OF THW WORLD--CANNOT BE UNDERESTIMATED. THIS REPRESENTS A GOLDEN OPPORTUNITY FOR THE US IN TERMS OF OUR PRESENT AND FUTURE RELATIONS IN THE MIDDLE EAST WHICH IT WOULD BE A CRIME TO LOSE.

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12. I AM CERTAIN THAT CONGRESS DID NOT COMPREHEND THE FULL IMPLICATIONS OF ITS ACTION IN ADOPTING THE CURRENT PROVISIONS PERTAINING TO TAXATION OF OVERSEAS AMERICANS IN THE TAX REFORM ACT OF 1976. I BELIEVE IT IS THE RESPONSIBILITY OF THE ADMINISTRATION TO ACQUIRE CONGRESSIONAL MEMBERS WITH THE FULL SIGNIFICANCE OF THE ACT'S IMPACT ON US FOREIGN POLICY AND OBJECTIVES. I STRONGLY RECOMMEND THAT THE DEPARTMENT URGENTLY UNDERTAKE AN ACTIVE CAMPAIGN, TOGETHER WITH THE DEPARTMENTS OF TREASURY, COMMERCE, HEW, LABOR, AND OTHER AGENCIES WHICH SHOULD BE CONCERNED WITH THE PROBLEM, TO
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PERSUADE THE CONGRESS TO AMEND THESE OBJECTIONABLE AND
DISCRIMINATORY PROVISIONS OF THE TAX REFORM ACT IN ORDER TO
GIVE MORE EQUITABLE TREATMENT TO AMERICANS EMPLOYED OVERSEAS
AND TO REVERSE A DELETERIOUS TREND UNDERMINING US POLICY
OBJECTIVES WORLD-WIDE WHICH HAS ALREADY BEGUN TO DEVELOP
HERE IN THE MIDDLE EAST.
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Message Attributes

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